

Another Mission Accomplished Goes Unaccomplished

“How can you do it...defend someone who’s guilty, I mean?” Can’t begin to tell you how rich I’d be if I had a nickel for every time I got that, but I can tell you my latest anecdotal response.

It’s the story of a former New York Stock Exchange specialist. His name is David Finnerty, and he traded General Electric Co. stock for Fleet. His case is one of several that began with a two-year federal probe of specialists. Finnerty was the specialist in GE.

The case went to trial in October before Federal District Judge Denny Chin of the Southern District of New York, an exceptionally thoughtful and well-respected Judge. The prosecution argued that investors lost approximately \$4.5 million because Mr. Finnerty bought shares at a relatively lower price for his firm’s account and sold them to investors at a relatively higher price. Calling this activity “inter-positioning,” the U.S. Attorney’s determined it to be illegal. They argued that Mr. Finnerty should have only matched the customer buy orders to other sell orders directly, without ever “inter-positioning.”

David Finnerty was one of 15 specialists charged with fraud in April 2005, which at the time was trumpeted by the government as a big, important victory against corrupt specialists and the firm they work for. Mr. Finnerty was found guilty, but two others were found not guilty. The charges were later quietly dropped against another seven. That left prosecutors with two guilty pleas and three other convictions (excluding Mr. Finnerty) as the only five remaining out of their triumphant 15 specialists they had “caught.” That’s probably not the way the much heralded biggest ever Big Board crackdown on illegal trading was supposed to look, but it was the recent ruling by Judge Chin in the case of Mr. Finnerty that really made the prosecutors look like President Bush declaring “Mission Accomplished” on that aircraft carrier.

Having obtained their conviction against Mr. Finnerty from what we can only gather was a very confused jury, Judge Chin yesterday overruled the conviction, ruling that the prosecutors failed to prove that Mr. Finnerty “engaged in fraudulent or deceptive conduct” under the securities laws. Too often, if a jury gets confused, they look for a “bad guy.” In cases that involve Fleet’s GE Specialists, as opposed to, say, a homicide, the bad guy behavior is harder to find. A prosecutor can’t just point the finger at someone, tell you what they did was illegal, and make it so (although, as this case demonstrates, the technique works). The law, nevertheless, still requires proof of wrongdoing.

That was Judge Chin’s problem with the conviction. “The evidence at trial did not establish that Finnerty’s customers were misled or defrauded or otherwise deceived.” In other words, fraud requires a showing of someone (let’s call him Joe) being defrauded. If you lead Joe to think you’ll do one thing, but instead, you do something else, then maybe there’s fraud. But doing the same thing without Joe having any expectation of whether you’ll do anything at all, well, it might be bad, but its not actionable fraud.

Judge Chin wondered in his ruling: “Did customers even know that a specialist could trade for his proprietary account?” ... “Did customers assume that the specialist was providing services without charge?”

I don't know. I have no idea what the customers thought. But I know that government types on all levels should perhaps trumpet their early successes either far more quietly or farther on into the future, once the real results are in. As for how I can defend “someone who's guilty,” well, everyone is constitutionally entitled to a defense, of course, but in the whole “Big Board Specialist Illegal Trading Probe” the government just gave us 10 out of 15 awfully compelling reasons.